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No. 112.

In the Supreme Court of the United States

October Term, A. D. 1927.

AETNA INSURANCE COMPANY, AGRICULTURAL INSURANCE COMPANY, ALLIANCE INSURANCE COMPANY OF PHILADELPHIA ET AL., *Petitioners,*

vs.

BEN C. HYDE, Superintendent of the Insurance Department of the State of Missouri, *Respondent.*

PETITIONERS' REPLY BRIEF.

CHARLES E. HUGHES,
ROBERT J. FOLONIE,
WILLIAM S. HOGSETT,
JOHN S. LEAHY,
ASHLEY COCKRILL,
Counsel for Petitioners.

BYRON-JACKSON, LAW PRINTERS, KANSAS CITY, MO.

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REPLY BRIEF FOR PETITIONERS.

Some of the arguments advanced by counsel for the Superintendent in their brief have been anticipated and answered in the petitioners' original brief. We shall confine this reply brief to a discussion of certain of counsel's points not covered in the original brief, avoiding repetition as far as possible.

There is one erroneous statement in the Superintendent's brief which does not bear directly upon *any*

particular question here presented for decision, but which in fairness should be corrected.

At page 7 of his brief the Superintendent says:

> "During the trial of this case, after the reduction was ordered, the state offered testimony to show that the reports (filed by the insurance companies with the state) were false and unfair; and finally, during this trial, petitioners were compelled in open court to admit that such sworn reports filed with Missouri were inaccurate, unfair, contained many duplications, and were indefensible (R. 535, 299, 522)."

The statement that petitioners were "compelled to admit" is a very inaccurate and misleading statement. So far from petitioners being compelled to *admit* the inaccuracies and duplications in the reports referred to (the so-called Reports of Underwriting Experience by Classes), the fact is that petitioners throughout the trial affirmatively asserted and established by the evidence that the ambiguous, incomplete and confusing form of these report blanks (devised by the insurance department) necessarily produced ambiguous, incomplete and inaccurate reports by the companies (R. 1855-1908, 196-7, 380-6, 387-393, 443-6, 535-6, 603-7, 668-9, 675, 2083-5, 2273). The blanks contained many duplications and overlapping requirements. In the blanks for some of the five years of the test period reports of certain classes of insurance were required while in the remaining years these classes were excluded. As a result of ambiguities in the blanks it was an utter impossibility for the petitioners, using such blanks, to accurately report their experience. *This fact was so clearly shown that the*

Superintendent himself (R. 2273) *and his chief witness McGee* (R. 2083-5) *admitted that the imperfections in the blanks would account for discrepancies and inaccuracies in the reports made thereon.* In the light of this sworn testimony by the Superintendent and his chief witness, it now comes with very poor grace for his counsel to charge the petitioners with having made false reports to the state.

It is most important to note that the figures in evidence upon which this case was tried were not taken from these inaccurate reports (the so-called Reports of Underwriting Experience by Classes), but were assembled and put in evidence from petitioners' books and records, independently. The errors in such reports therefore do not affect the result herein in the slightest degree. In fact, the Reports of Underwriting Experience by Classes have nothing to do with the case whatever, except as the Superintendent may seek to obscure the facts by talking about them.

I.

The method of calculation of petitioners' profit or loss upon the basis of premiums received less losses and expenses paid, instead of upon the basis of premiums earned less losses and expenses incurred, is fundamentally erroneous, unreasonable and confiscatory.

1. At page 17 of the Superintendent's brief it is stated that the fire insurance rating act was enacted as the result of an agreement between the state officials and the insurance companies, and the matter is stated in such a way as to convey the impression that the agreement contemplated the calculation of profit on the received and paid

basis. The record fails to support any such idea. The evidence fails to show that when the rating act was drafted there was any discussion one way or another as to the proper method of calculating underwriting profit. (R. 2305-6.) Furthermore the statute as enacted must speak the legislative will, and the intent of the draftsmen is wholly irrelevant. (*Belleville Railway Co.* v. *Gregory*, 15 Ill. 20; *Richmond* v. *Henrico County*, 2 S. E. (Va.) 26; *Tennant* v. *Kuhlemeier*, (Ia.) 120 N. W. 689; 36 Cyc. 1137; *Steamboat Co.* v. *Transportation Co.*, 18 N. J. Eq. 13, 24.)

2. At pages 17-18 of the Superintendent's brief he says that on two previous occasions the insurance companies applied for and received an increase in rates on the received and paid basis. It is true that the insurance companies, once in 1915 (R. 2833-5) and once in 1918 (R. 2311), deferring to the position taken by the Insurance Department, applied for increase of rates and submitted their underwriting experience upon the received and paid basis. However, the record discloses the reason for this: The received and paid basis had been adopted by the Insurance Department since the then recent enactment of the Rating Act in 1915 (R. 2302, 2744, 2837-8), *and the Insurance Companies chose to deal with the Department upon its own basis;* and even upon such basis, which was more favorable to the State than the earned and incurred basis would have been, the companies were actually found entitled to the increases asked (R. 2835, 2330-3).

The Superintendent produced in evidence the record in the case of *State ex rel. Waterworth* v. *Harty*, 278 Mo. 685 (commonly referred to as the Surcharge Case); and his counsel now refer to that case as one of the two instances wherein the petitioners employed the received

and paid method, and seek to put petitioners in the position of having in that case sponsored the method as correct. The Surcharge Case was not a general rate revision case but was a proceeding by the Insurance Companies to secure a temporary surcharge because of the increased cost of repairs in partial loss cases due to war conditions.

While the companies in that case did introduce evidence upon the received and paid basis, because the Department chose to use that method in its dealings with the companies, nevertheless the companies did not admit its correctness even in that proceeding. They asserted in that case that the unearned premium was a liability which should properly be taken into account in any profit and loss statement.

Witness James A. Waterworth, manager of Missouri Inspection Bureau, and one of the relators in the case, testified in detail as to the unearned premium reserves. Among other things he said. (R. 2405-6):

> "Q. Colonel, you are familiar with the system of the Departments in charging the companies with reserves are you not? A. Yes, sir. The companies are compelled by law to put away in a reserve fund 50 per cent of the entire premiums received on annual business and a prorated amount on two and three year business; that is, two-thirds on three year business and four-fifths on five year business. That is to say they have out of the permiums of the year—they have to maintain a fund equal to about 60 per cent of the entire premiums received during the year.
>
> Q. Well, that is the practice of the companies? A. Oh yes; they have to do that; the law requires that.
>
> Q. And they do do it? A. Yes, they do it."

Witness Harold M. Hess, Associate Manager of Missouri Inspection Bureau, testified on such hearing and explained the unearned premium reserve in detail. Among other things he said (R. 2443):

> "Q. Now have you stated the uniform practice in giving the percentages? A. Yes, that is the requirement of the Insurance Departments of all states as decided upon by the Insurance Commissioners in convention and established and used uniformly by the companies in reporting all their figures. * * *
>
> Q. Well, how do the insurance companies treat these reserves? Do they treat them as an asset or a liability? A. They have no choice in the matter. They are a liability because the unearned premium reserve cannot be used for any purpose whatsoever. It is a fund kept on deposit for the protection of the policy holders in case the company goes out of business and reinsures its risks, or in case the policy holders desire to cancel their policies before their expiration.

In effect the insurance companies used the received and paid basis because the department with which they dealt desired it, but they explained in that suit the proper basis which ought to be employed, namely, the one for which petitioners here contend.

However, as pointed out in our original brief, the Superintendent cannot justify a confiscatory rate on the ground that the insurance companies by their former conduct have become estopped from charging a compensatory rate (*Southern Pacific Company* v. *Interstate Commerce Commission*, 219 U. S. 433.)

3. At page 8 of his brief the Superintendent argues in effect that all of the reports filed by the insurance companies with the state are "on the basis of premiums re-

ceived, losses and expenses paid." The record is uncontradicted that the annual statements filed by all companies with the state of Missouri include *only one report of underwriting profit or loss.* This report shows the underwriting profit or loss from the nation-wide business of the respective companies, *and it is upon the earned and incurred basis.* This fact is indisputably shown by a sample copy of the annual statement blank itself at page 1285-7 of the record.

But the Superintendent argues that this blank does not contain any report of the *Missouri* business on the earned and incurred basis, and so he argues that he cannot calculate underwriting profit or loss on that basis for rate-making purposes. In answer to this we point out that Sec. 6281 R. S. Mo. 1919 (printed in the appendix to our original brief) requires the insurance companies to report to the Superintendent such information *as he may require.* The Superintendent has *carte blanche* authority to require a report of Missouri experience upon the earned and incurred basis, if he desires it. He may require the reporting of premiums received, premiums earned, or both, at his will. As the Arkansas Supreme Court said in *Bullion* v. *Aetna Insurance Co.*, 151 Ark. 519, 237 S. W. 717:

> "Any question as to the manner of securing the necessary data to report on either basis may be disposed of by saying that the law gives the Commissioner the right to call for such data as he sees proper to have, and imposes upon the companies the duty to furnish it."

4. At page 9 of his brief the Superintendent says that "four of the best known presidents of fire insurance companies in the United States testified unequivocally" that

the earned and incurred method is "absolutely impossible"; and at page 27 of his brief the Superintendent, after quoting a part of the Missouri Supreme Court's opinion rejecting the earned and incurred method, says:

> "The Missouri Supreme Court could not have held otherwise, because numerous witnesses for these insurance companies testified that the method now contended for by them, of premiums earned, losses and expenses incurred, was inaccurate, uncertain, and used solely for the purpose of securing the results contended for by them in this case.
>
> The following witnesses testified for the insurance companies and, in effect, stated that the method now contended for by these insurance companies could not be used for rate making purposes:
>
> Witness Toles, R. 120-125.
> Witness Hendele, R. 215-216-428.
> Witness Bush, R. 310-311-312-306-307-317-318.
> Witness Groth, R. 502-503.
> President Jameson, R. 1145-1146-1171-1172.
> President West, R. 1190-1191-1192-1211-1212.
> Vice Pres. Buswell, R. 1293.
> President Lane, R. 722-754-755."

Even if these witnesses had so testified (and they did not) it would not be controlling, because the question as to the proper method of calculating underwriting profit is a question of law, not a question of fact, and the evidence of expert witnesses bearing on the question of accounting involved therein is purely advisory (see cases cited at page 117 of our original brief).

However, the fact is that none of the witnesses mentioned testified as stated by the Superintendent. No one of the witnesses mentioned, nor any other witnesses produced for the petitioners testified that the earned and in-

curred method was inaccurate, uncertain, and used solely for the purpose of securing the result contended for. To demonstrate the unfounded character of the statement by the Superintendent, it is necessary for us to call attention to the evidence of these witnesses somewhat in detail. We greatly regret the necessity of entering into the detail of the matter and of challenging the good faith of the Superintendent in making the statement quoted; but the statement is so utterly baseless that we can deal with it in no other way. We shall quote from the pages cited by the Superintendent the portion of the record to which evidently he makes reference, and call to the Court's attention other portions of the evidence of the same witnesses, so that the Court may have an understanding of the whole testimony of the witnesses as to the particular question involved.

Witness Toles testified on cross-examination by the Superintendent's counsel (R. 120):

> "Q. Now, when you include, then, the unearned premium or premium reserve at the beginning, and exclude it at the end, if there is an ascending conduct of business, why the *apparent* profits are cut or reduced, aren't they? A. If your unearned premium increases, your earned premium would be less.
>
> Q. And your profits would be reduced? A. Yes, sir.
>
> Q. Is that the reason you use that method in establishing an experience of five years for the purpose of arriving at a rate? A. Arriving at a rate of what?
>
> Q. Arriving at the justice of a rate with reference to profit or loss? A. I would say so."

If there were nothing else in the evidence of this witness on the subject, his last answer in particular would be ambiguous and might give some comfort to respondent.

His answer as to the reason for adopting the earned and incurred method was evidently designed to mean that it was used because the increase of unearned premium would justly be used as reducing the earned premium figure as compared with what the written figure was; but the witness's meaning when his whole testimony upon the subject is considered, is not left in doubt.

Evidently the matter referred to at R. 125 is the following, also appearing in the cross-examination:

> "Q. But when you include on an ascending rate of business at the end of the five-year experience, you are charging a proportionately greater expense than you excluded at the first of the term, don't you? A. Possibly.
>
> Q. Now, the reason for figuring these matters in this fashion and adopting the earned premium as against the incurred loss and expense system is that it diminishes apparently at the end of the five-year experience the profits or earnings of the company, doesn't it? A. Not necessarily.
>
> Q. Well, don't you think it does, as a practical matter, during the past five years, running up to 1921? A. Yes."

The same witness testified on re-direct examination by petitioners' counsel (R. 178-9):

> "Q. And if you computed it with the figures at the beginning and at the end of one year, you would therefore arrive at the earned premiums for a one year period? A. Yes, sir.
>
> Q. And if you did it at the beginning and at the end of five years, you would have the earned premium for five years? A. Yes, sir.
>
> Q. I will ask you whether there is any other method known to you for correctly computing earned

premiums over a given term than the method mentioned? A. No, sir.

Q. Is such a method in common and general use in computing and calculating such an item? A. Yes, sir."

At R. 181-2, the same witness also testified on re-direct examination:

"I would say, if you want to know the profit or loss made by an insurance company, you would have no other basis to take except the earned premium basis.

Q. Can you elaborate and state why? A. Well, in case your company should become embarrassed or become obliged to reinsure, the unearned premium is an item which would have to be paid out and could not be considered as a part of the profits of the company until after it had been earned."

The same witness said on re-cross-examination (R. 195):

"Q. You don't agree with the method of taking the premiums collected for a year over a five-year experience, and calculating the losses paid each year, and the expenses paid, as arriving at an underwriting experience? You don't agree with that? A. No, I do not.

Q. Because you say there was a possibility of what? A. I don't know what you mean.

Q. Well, you gave a reason to Mr. Folonie. A. But not of any question like that.

Q. You did not? Have you a reason for objecting to that? A. I would say it doesn't reflect the true condition of the company.

Q. Why? A. Because you are taking into consideration the unearned premium part of your premium."

Being interrogated as to the correctness or incorrectness of the basis of the premiums received and losses and expenses paid, the same witness further testified on re-cross-examination (R. 195):

> "Q. Do you say that that wouldn't reflect the experience of that company over a period of five years by taking each year in that portion? A. It would not reflect their profits.
>
> Q. It would not reflect? Why not? A. Because a part of that premium is unearned, and it remains as a liability. The company might have to return it. Suppose the company became insolvent; it would have to return it."

The same witness at page 196 says on further re-cross-examination:

> "Q. But over a five-year experience, isn't that (the received and paid basis) the best way of arriving at it? A. No, sir.
>
> Q. You prefer the other system of incurred losses and incurred expenses? A. Yes."

Three citations to the record are made by the Superintendent's brief respecting the *witness Hendele*. The matters apparently referred to at R. 215-216 are as follows (cross-examination by the Superintendent's counsel):

> "Q. Therefore, if you took an earned premium basis at the beginning of 1917 and at the end of 1921, your earned and unearned premiums both will be largely in excess of your earned and unearned premiums at 1917? A. Well, that would be the natural course of events.

Q. Certainly. So that in figuring on an earned basis, then, rather than a paid basis, that would increase your expenses in Missouri and limit your profit in Missouri. That would be the effect of it? A. Naturally so.

Q. Yes. And that is why you do it? A. No, sir.

Q. It is not? A. No, sir.

Q. Just happens that way? A. Well, I can't control the result.

Q. I see. You are not the manager, managing officer or president of this company. You don't tell me that that is a proper system of accounting, do you? A. I do.

Q. You do? A. Yes, sir.

Q. Don't you think it would be better for you to start out on the first day of 1917 and say that on this day we received $100, and next day we received $50, and right on through each day of the year, and at the end of the year total it up and know just exactly every dollar which you had received and put in the bank that year—wouldn't that be a better system? A. Theoretically, that would be an ideal way to conduct the business, but there is a certain income that you have that is not entirely earned the minute you get it; consequently you have got to set up a reserve for some cash that you receive today for what is going to happen next year."

The Superintendent's next citation is R. 428. The reference is evidently to the following matter on that page (cross-examination by the Superintendent's counsel):

"Q. Now then, on an ascending scale of business there is more to deduct at the end than there is to add at the beginning, of course? A. Naturally so.

Q. And your business during these five years was on an ascending scale? A. I think it was.

Q. What is that? A. I think it was.

Q. Now, whatever may have caused that, the effect of your accounting is that your companies get the best of the method of figuring, and Missouri gets the worst of it, as it happens? A. As it happens. That is not the reason I made the calculation.

Q. I realize that. I know you wouldn't do that for any such purpose, but the result is as I have stated, is it not? A. Yes."

The same witness also testified on cross-examination (R. 209):

"Q. Now, you figure, I believe, from the earned premium basis and the incurred loss basis and the incurred expense basis rather than the premium paid basis, the loss paid basis and the expense paid basis? A. Yes.

Q. Why do you do that? A. Because I think that is the only proper way to examine underwriting profit.

Q. What do you mean by saying that you think that is a better way of figuring it? Give me your idea as to that. A. I said I thought it was the proper way to figure it.

Q. Well, tell me why? A. Because I can't see if you have received a certain amount of cash and in a certain year, why you should determine a profit on your income when you cannot consider that all of that is yours right there. In other words, you have got an unearned premium reserve to deal with. Your premiums are never entirely earned until your policies have expired."

The same witness also said on cross-examination (R. 218):

"Q. Oh, I realize you have certain expenses, but do you tell me there is a difference with reference

to keeping a reserve whether the insurance is treated as paid or earned, that there is a difference in keeping a reserve? A. Surely. You can't take your entire income and say it is all yours for a minute. It is yours in a sense, but you have to do something else with it. You can't use it to pay losses and expenses with, completely."

The same witness also testified on cross-examination (R. 227):

"Q. Now then, if we could take them all, premiums received instead of premiums earned, it would be much easier to calculate, wouldn't it? A. I wouldn't say it would be any easier. It is not the proper way.

Q. It is not the proper way? A. No, sir."

The same witness also testified on cross-examination (R. 227):

"Q. Now, in counting your earned premiums on an ascending scale with an increase of business, for instance, unearned premiums. If you had unearned premiums on the first of January, 1917, of $10,000; unearned premiums. Now, on the first of January, 1922, you would necessarily have a greater rate of unearned premium—volume of business being greater—wouldn't you? A. Yes.

Q. And that is why you figured on the unearned premium instead of on the paid premium? A. No, I stated before that is not my reason for doing it.

Q. Isn't that the reason known and recognized by fire insurance accountants? Haven't you heard them discuss that reason? A. Because it produces a greater or lesser figure?

Q. Yes. A. No.

Q. That is not the reason? A. No, sir."

On re-direct examination the same witness testified (R. 228):

> "Q. Isn't the real reason why because it is the only method of reflecting the actual experience of the company during a given period? A. Yes, sir.
>
> Q. Do you know any insurance company in the country, from your experience in the business, that figures its profit or loss on any basis except the earned premium basis? A. I don't know.
>
> Q. Did you ever hear of an insurance company that undertook to figure a profit or loss that did it on a paid or a cash basis? A. No, sir.
>
> Q. Did you ever know of an insurance company that figures its profit or loss on any basis except the incurred loss and incurred expenses? A. No, sir.
>
> Q. Is that the way you would figure profit or loss on your business for the manager, if he would come in and ask you what the status of the company was as of a given time—you would figure it on identically this same basis? A. I would, if I was in possession of all the figures at the time."

We next call attention to the pages of the record to which the Superintendent calls attention, as respects the evidence of the *witness Frank Bush*. The matter evidently referred to at R. 310 is as follows (cross-examination by the Superintendent's counsel):

> "Q. Now, Mr. Bush, the net result of your method of figuring losses and profit ratios by means of earned premiums and incurred losses and paid expenses, from the figures that you have actually developed, is that the system is to ostensibly reduce the ostensible profits and increase the ostensible losses, isn't it? A. Well, it was done for the purpose of trying to arrive at an accurate result, as nearly as I could get at it."

The matter at R. 311 evidently referred to reads as follows (cross-examination):

> "Q. The result is a matter of accounting, of the system which you employed, namely, the earned premiums, incurred losses and paid expenses, is to reduce the ostensible profits or increase the ostensible losses, isn't it? A. No, I would say not."

The matter evidently referred to at R. 312 is as follows (cross-examination):

> "Q. Well, isn't the practical effect of your figuring to reduce the profits or increase the losses over—if you used the paid system of losses and the written premiums? A. Yes."

The matters evidently referred to at R. 306 and 307 are as follows (cross-examination):

> "I used paid losses in arriving at that result.
> Q. Only as a method of figuring to get to what? A. To the incurred losses.
> Q. To the incurred losses? Now, you base your question of profit or loss on earned premiums? A. Yes, sir.
> Q. Incurred losses? A. Yes, sir.
> Q. And incurred expenses? A. Yes, sir.
> Q. That is right, isn't it?
> Q. Why did you use paid expenses in arriving at the result? A. Because I knew of no items that were set up at either the beginning or end of the year as affecting the State of Missouri."

Matters evidently referred to at R. 317 and 318 are as follows (cross-examination):

> "Q. When you arrive at a loss percentage or a profit percentage, do you figure against the total

volume of business done? A. I figured it against the earned premiums.

Q. What I want to get at is, how they would arrive at that amount (amount payable as dividends)? Would you take the amount of capital stock and figure what your profit would be, or would you base it upon volume of business? A. I should say, you would take your trading statement and set up your earned premiums, and charge against it your expenses and your losses, etc., similar to the method we have, and arrive at the balance, and if there was a profit there, you could pay it out."

The same witness further testified on direct examination (R. 263):

"Q. So far as your books disclose, incurred expense and paid expense are an identical amount? A. Yes, sir."

The same witness testified on cross-examination (R. 313):

"Q. Now, why didn't you use the system of paid losses in arriving at your conclusions instead of incurred losses? A. Because I was attempting to arrive at the correct result, and incurred losses would be, I should say, the correct method of entering a loss charge in my computations, rather than paid."

The portion of the evidence of *witness Groth* at R. 502 is on cross-examination where the witness said:

"Q. You think that is a reasonable expense, Mr. Groth? A. It is figuring it on an earned premium basis.

Q. Well, you think that accurate? A. It is as accurate as it is possible to get an expense ratio

figuring it on an earned premium basis; as accurate as we possibly could get it.

Q. In other words, when you figure on an earned premium basis it naturally makes your expense ratio ascend, does it? A. Yes.

Q. And the result is—and that is true of losses too, isn't it? A. Yes."

The portion of the evidence of witness Groth evidently referred to at R. 503 is as follows (cross-examination):

"Q. And this 73.8 per cent does not reflect the true condition if you take into consideration all the premiums you received, does it? A. No, it does not."

The same witness also testified on cross-examination (R. 510):

"Q. Now, what do you regard unearned premium reserve? Do you regard that as a liability? A. Yes, I do."

As to the remaining witnesses named, the record is as follows:

Witness Jameson, president of the Globe & Rutgers Fire Insurance Company, did testify, by inadvertence, at pages 1146 and 1172 of the record that written premiums formed a proper basis for profit calculation. The Superintendent fails to point out, however, that this witness corrected his statement and later stated explicitly that earned premiums formed the proper basis and that if he had previously said written premiums, it was through inadvertence (R. 1173).

As to *witness West*, the record shows that the term "premiums received" was contained in counsel's question

and not in the witness's answer, although the question and answer combined do convey the impression that the witness approved of the received and paid basis (R. 1190-2). Counsel for the Superintendent fail to call attention to the fact that this same witness, in answer to their further questions, corrected his testimony and, when his attention was called to the fact that he had used the term "premiums received" in stating the proper basis for profit calculation, answered (R. 1205):

> "Well, I am inclined to think I may have said that hastily. What I meant, of course, was premiums *earned*. There is nothing in this 'premiums received.' We, in insurance parlance, always talk of premiums *earned*, because on premiums received it doesn't mean anything at all." (Italics ours.)

The next record page cited is R. 1211, where the same witness, further testifying, says in speaking of the *earned* premium method after giving the detail of its computation:

> "Q. Now, that is the process. Well, now, you say that should furnish the basis of calculation for rates? A. Yes, sir."

The witness's evidence at this page clearly shows that the earned premium method is correct and not the contrary, as counsel state in their brief.

The *witness Bunnell*, vice-president of the Home Insurance Company, far from stating that the premium received basis was proper, testified at the page cited (R. 1293) as follows:

> "Q. In determining whether or not you have made a loss or profit in a given state in a given

> period, can you tell me how you ascertain that fact? A. Yes, losses incurred and expenses, and the increase or decrease in the unearned premium reserve."

This is an explicit approval of the earned premium method and not the premium received method.

Witness Lane, president of the Niagara Fire Insurance Company, stated that his company uses earned premiums, incurred losses and *paid expenses* (R. 698-9, 722, 754). As we pointed out in our original brief, the difference between paid and incurred *expenses* is negligible, and a number of witnesses make no effort to use incurred expenses, because the paid figure serves their convenience and there is no substantial difference between the two (R. 3019).

There is no evidence whatsoever in this record to support the statement of the Superintendent that witnesses Jameson, West, Lane or Buswell (referred to by the Superintendent as "four of the best known presidents of fire insurance companies") or witnesses Toles, Hendele, Bush or Groth, or any other witnesses for the insurance companies testified that the earned and incurred method "could not be used for rate making purposes," or that such method was "used solely for the purpose of securing the result contended for by them in this case." The Superintendent's statement of the effect of their testimony (at page 27 of his brief) is without the slightest vestige of support in the record.

5. At page 54 of his brief the Superintendent says:

> "The testimony in this case demonstrates conclusively that fire insurance companies do not set aside, ear-mark and maintain a reserve of any kind. That the money originally comes from policy holders

> and thereupon is loaned out. All of the money is placed together and payments made out of the general fund. * * * They claim they maintain a premium reserve but they do not set aside such reserve and keep it separate and apart from their other funds. They claim they maintain other reserves, but what they really mean is that purely as a bookkeeping entry and fiction they attempt to show by their books what money belongs to certain funds."

The Superintendent appears to have a very singular conception of the nature of the reserve. According to his apparent notion, a reserve must be physically segregated from the general funds of the company; and if the funds are all kept together, then there is no reserve. Of course, this is an entirely fallacious notion.

The nature of the unearned premium reserve is simple and easily understood. An insurance company has certain assets. Against such assets it is required by law to set up certain liabilities, one of which is the amount of its unearned premiums. This liability so set up is called the unearned premium reserve. The purpose and actual effect of the statute requiring the reserve is to compel the company to keep an equal (offsetting) amount of its assets ready and available, to be used for future payments of losses and expenses, or the return of premium on cancellation. The amount of the reserve, in dollars and cents, changes from day to day as existing policies earn more premium or expire, and new policies are written. As long as the company has outstanding any unexpired policies upon which it has not fully performed its obligations, it must continue to maintain a reserve adequate to protect its policy holders upon such future, unperformed obligations.

The unearned premium reserve is no mere bookkeeping "fiction," as the Superintendent argues. It is a thing of substance. The reserve statute has the very practical effect of withdrawing from funds which would otherwise be free surplus applicable for dividends, a very substantial percentage (Sec. 6333, 6222, R. S. Mo. 1919).

Since the unearned premiums cannot be disbursed as dividends, it is poor logic indeed to denominate them "profits."

6. At pages 51 and 52 of his brief the Superintendent, referring to Sec. 6222 R. S. Mo. 1919, requiring petitioners to set aside the unearned premium reserve, argues:

> "This section has nothing in the world to do with rate making, but simply requires these fire insurance companies to maintain this reserve to safely insure their risks in case they become insolvent, go out of business, or desire to sell their business. Such section is not a part of the Missouri rating act and has nothing to do with rate making."

While the reserve statute may not be a part of the rating act, it is nevertheless a binding statute of the state, with which petitioners must comply. In order to comply with it, petitioners must set up the unearned premium reserve as a liability. And by another statute (Sec. 6333, R. S. Mo. 1919) they are forbidden to pay dividends out of unearned premiums. Neither of these statutes is "a part of the rating act." Yet an insurance company would violate the law if it should distribute its unearned premiums in dividends, or fail to set up the reserve against them as required by the statute. It offends reason to say that unearned premiums, thus reserved, may be denominated "earnings" or "profits."

It is not important whether the reserve statute, or the statute forbidding payment of dividends out of unearned premiums, are parts of the rating act. What is important is the *effect* of these statutes, upon the unearned portion of the premiums. In the light of these statutes, unearned premiums cannot reasonably be treated as accrued profits or earnings.

7. At page 27 of his brief the Superintendent argues that "a reserve may be set up and maintained as well under the premium received theory as under the premium earned theory." May we ask how this could possibly be done? Under the received and paid method the unearned premiums are treated as accrued income, as the unqualified property of the petitioners, as profit subject to be disbursed in dividends. How then, logically, can the unearned premium reserve (a liability) be set up out of premiums which in the same tabulation are counted as accrued income or profit and as the unqualified property of petitioners? The very statement of the proposition involves a contradiction. If the reserve be properly set up, it will consist of the amount of unearned premiums, which, deducted from premiums received, leaves the earned premium as the net result. If this is done, it is the earned premium method which is actually used. But if the Superintendent is right in his premium received theory, why set up any reserve? And if the reserve should be set up, how can he defend his rate order herein which reserves nothing? The statute requiring the setting up of the reserve (Sec. 6222 R. S. Mo. 1919) is consistent only with the use of the earned and incurred method of calculating underwriting profit.

8. At page 30 of his brief the Superintendent argues that "during prosperity and while the business of petitioners is increasing, their method (the earned and incurred method) will always show a very small profit or a loss."

A conclusive refutation of this contention is apparent from the figures in the record showing that a profit was derived in Missouri in 1917 and 1918 by thirty of the companies, in 1919 by seventy-three, in 1920 by thirty-seven and in 1921 by thirty-one companies; and in 1919 the aggregate experience of all of the companies showed a $1,153,263 profit—upon the earned and incurred basis (see Plaintiff's Exhibits 1354 to 1359 at R. 1924).

9. At page 73 of his brief the Superintendent says:

> "If business is on an ascending scale and is prospering, by this curious method of calculation (the earned and incurred method), there will apparently be no profits; if the business is declining, by this method of calculation there will apparently be large profits."

This assertion of the Superintendent is founded upon an utterly fallacious conclusion of his witness McGee. That McGee's conclusion is fallacious is demonstrated (from his own figures) at pages 76-78 of our original brief. It is not true that upon an ascending scale of business the earned and incurred method will show no profit, and upon a descending scale of business will show large profit. The witness McGee's conclusion is founded upon assumptions which are impossible and preposterous on their face, as shown at pages 76-78 of our original brief.

10. At page 73 of his brief the Superintendent inferentially attacks the method of *computing* earned premiums and incurred losses and expenses. He states the method of computation in such a way as to make it seem very confusing. In fact it is perfectly simple, as the opinion below makes clear (R. 3017-18). The method of *computation* (as distinguished from the propriety of adopting

the earned and incurred basis at all) was not challenged at any place in the record, and could not be. The method employed is correct, as the opinion expressly finds (R. 3017-18, and see also R. 1947, 178-180, 227, 232, 497, 699-700, 708, 1206.) It is the method prescribed by the Missouri annual statement blank (R. 187-190); that is to say, the method of computation (which the Superintendent's counsel now inferentially attack) is one *prescribed by the Superintendent himself* (see Exhibit following page 2742 of the record) and by the insurance department of every other state (R. 181, 709, 863, 2142, 2806-7, 2850-7). It is the same method prescribed by Congress in the income tax law (see appendix to our original brief). The Superintendent's actuary and chief witness *expressly admit its correctness* (R. 2130-1).

Even where absolute accuracy of computation in rate cases is impossible, but where methods are available which produce results substantially or even approximately correct, this court has sustained them.

> *Union Tank Line Co. v. Wright*, 249 U. S. 275, and cases there cited.

II. At page 29 of his brief the Superintendent seeks to escape the persuasive effect of the adoption of the earned and incurred method by Congress in the levy of income tax, and seeks to draw some distinction between the ascertainment of profit for rate-making purposes and the ascertainment of profit for taxing purposes. But obviously the Superintendent's argument is without merit. The clear intent of Congress in the levy of income tax is to ascertain the true *profit* of the insurance company for the taxable year. Congress, fully recognizing that this ascertainment can only be made on the earned and incurred

basis, has expressly adopted that basis as part of the income tax law (Sec. 246 of Revenue Acts of November 23, 1921, June 2, 1924, and February 26, 1926, printed the appendix to our original brief). If the profit of an insurance company could only be ascertained on the received and paid basis, doubtless Congress would have adopted that basis as a part of the income tax law. It is a cogent fact of most persuasive force that the income tax law uses the earned and incurred basis.

12. At pages 9 and 53 of his brief the Superintendent argues that the use of earned and incurred method "would mean a return of at least 500% to their stockholders (R. 895)." This assertion is entirely unsupported by the record. The court will find at the page of the record cited, that the Superintendent's counsel sought to make a 600 per cent profit appear as to one specified company, and the witness stated that, assuming the correctness of the statement, it failed to take into account that another company under the same management had conducted business at a loss. None of these inquiries related to the business of either company in Missouri, or to the aggregate experience of all the companies in Missouri; and the Superintendent's statement that such is its effect is without support in the evidence.

While obviously the amount of return to stockholders upon the companies' nation-wide business as a whole (including earnings from investments) is not material or relevant in this case, which involves only the fixing of a rate level in Missouri for underwriting, yet the fact is that upon the nation-wide business as a whole of all the petitioners during the five-year period the cash dividends were only *6.39 per cent* of capital and surplus and the cash dividends plus accretions to surplus were only *10 per cent* of capital and surplus (R. 1361-4, 1369). In the face

of this undisputed fact, the reckless extravagance of the Superintendent's suggestion of a possible 500 or 600 per cent profit becomes manifest.

13. At pages 50-51 of his brief the Superintendent says:

> "At the beginning of 1920 these companies were granted an increase of 15 per cent and the present reduction order now questioned and before this court was to become effective in October, 1922, reducing the then existing rates 10 per cent, which would allow the companies to still receive 5 per cent of the 15 per cent increase granted them in January, 1920. In other words, this reduction of 10 per cent in October, 1922, was leveled against the 15 per cent increase granted these companies in January, 1920, and did not affect the rates at all on which they earned this enormous profit, and in the future years they will still receive 5 per cent more than they received during this period."

As a matter of fact, the Superintendent's evidence shows that the January, 1920, increase in rates was a 15 per cent increase applicable to only 71 per cent of the business written (R. 2060). Notwithstanding this increase, which was reflected in the experience of the last two years of the test period, the experience of the five years showed an underwriting loss in Missouri of $7,010,200 on the earned and incurred basis (R. 3018, 3007). Obviously the 10 per cent reduction would only serve to increase this sustained loss.

The argument of the Superintendent proceeds upon the mistaken assumption that whether an experience is profitable or unprofitable, is to be determined alone by increase or decrease of income. In fact, whether there

is a profit or a loss is dependent not only upon income, but upon its *relation* to outgo. If income increases and outgo increases still more, there is an increased loss.

Whether a level of rates has undergone increase or decrease during a test period is not a matter of importance; the only pertinent inquiry is as to the *relation* which exists between income and outgo, and as to the *balance* which remains after subtracting the latter from the former.

It is significant that in the last two years of the test period, when the January, 1920, increase was in force, the deficiency of income to meet outgo was greater than during the preceding three years; and this is true upon the received and paid basis (Exhibit 1361 at R. 1934) as well as upon the earned and incurred basis (Exhibit 1359 at R. 1925).

14. At page 30 of his brief the Superintendent in referring to *Sun Insurance Office* v. *Clark*, App. Cas. L. R. 1912, p. 443 (House of Lords), quotes an extract from an opinion of the Kansas Supreme Court in *Aetna Insurance Co.* v. *Travis*, handed down October 8, 1927 (not reported), to the effect that petitioners "no longer contend that *Sun Insurance Office* v. *Clark* supports their contention."

In view of the fact that the opinion of the Kansas Supreme Court is not yet final (a motion for rehearing being now pending), we question the propriety of citing it.

It is difficult to understand how the Kansas Supreme Court could have gathered the impression that the insurance companies no longer contend that *Sun Insurance Office* v. *Clark* supports the earned and incurred basis. Certainly the insurance companies have never taken that position in the Kansas Supreme Court, or elsewhere. And

in their petition for rehearing now pending in the Kansas Supreme Court they say:

> "The court says that it is worthy of note that we no longer contend that *Sun Insurance Office* v. *Clark* supports our contention. We do not know how the court could have come to so erroneous a conclusion. We regard the case as conclusive of the case at bar and have in no way abandoned it, nor are we conscious of ever having said or written anything which the court could construe as in any sense an abandonment of the case. If there is anything anywhere in the briefs which gave the court that impression, then the court derived an impression squarely contrary to the intention of counsel for the plaintiffs."

15. At pages 38 to 44 of his brief the Superintendent quotes at length from the opinion in the Travis case, to which we have referred. It is sufficient to say that the record in the Travis case, to which the language of the Kansas Supreme Court was directed, is not now before this court for review, and the arguments of the Kansas court, which are based on the facts in that record, have no application to the record in the Missouri case now before this court. Whatever may have been the state of the record in that case, the proof of the petitioners in the case at bar is full and complete upon their theory of the case. The petitioners' figures were expressly accepted by the Superintendent as correct (R. 2072), and are found by the opinion to be undisputed (R. 3008-9).

In the case at bar there is no "fatal hiatus in the proof" as to the operating income of petitioners, to-wit, the earned premiums. The amount thereof is shown to the exact dollar, to-wit, $74,813,860 (R. 3007, 3034-5; see also plaintiffs' Exhibits 1359 and 1361 at R. 1925 and

1934). As to the proportion of premiums received which "ultimately become profits" (that is, become profits in the period following December 31, 1921), that is not a relevant matter of inquiry in this particular case. It will be relevant in some future rate inquiry and the proper amount will be credited to the state in any rate inquiry involving a period subsequent to 1921. But it is wholly irrelevant in this rate inquiry.

II.

The rate reduction order and the opinion below in so far as they apply $2,301,132 interest earnings from investments to a reduction of rates for underwriting, are confiscatory.

1. Counsel for the Superintendent have signally failed to answer the inescapable logic of the dissenting opinion with respect to the inclusion of investment earnings. They make no attempt to reconcile the fundamental inconsistency of the majority opinion in holding (a) that unearned premiums are accrued income and therefore the unqualified property of the petitioners, and (b) that interest earnings from the investment of such unearned premiums can be applied to a reduction of rates for underwriting. This matter has been fully covered at pages 84-94 of our original brief.

2. The Superintendent places great reliance upon a supposed admission by counsel for the insurance companies in a suit known as the Surcharge Case, the record of which was erroneously admitted in evidence over the objection of the petitioners (R. 2310). The supposed admission by the counsel for the insurance com-

panies in that case (quoted at pages 45-46 of the Superintendent's brief) is of no legal importance, for these reasons:

a. The parties in that case were not the same as the parties in this case (R. 2311, 2).

b. The Surcharge Case (which was not a rate reduction suit, but an action by insurance companies to compel the Superintendent to grant a temporary increase in rates, to offset increased costs of making repairs in partial loss cases, due to war conditions) was decided *against* the insurance companies, without a decision on the merits, as being a suit for relief which the courts had no jurisdiction to grant (*State ex rel. Waterworth* v. *Harty*, 278 Mo. 685). An estoppel does not arise under such circumstances (*Sturm* v. *Boker*, 150 U. S. 312, 335-6; 16 Cyc. 799; 10 Rul. Cas. Law, Estoppel, Sec. 29; *Davidson* v. *Davidson*, 155 S. W. 61).

c. The Superintendent claims that in the Surcharge Case counsel for the insurance companies admitted that interest on unearned premiums should be taken into account in ascertaining profit or loss for rate making purposes. Had such an admission been unqualifiedly made, and had the parties in that suit been identical with the parties in this suit, and had the suit been decided in favor of the companies, it would still be a matter of no importance. Such statement of counsel would have been a mere statement of opinion on a question of law, and would not operate as an estoppel. As this court said in *Sturm* v. *Boker*, 150 U. S. 312, 336:

> "Both the defendants and the insurance companies had the written contracts before them, and were presumed, as a matter of law, to know their legal effect and operation. What the complainant said in his testimony was *a statement of opinion upon a*

> *question of law*, where the facts were equally well known to both parties. Such statements of opinion do not operate as an estoppel. If he had said, in express terms, that by that contract he was responsible for the loss, it would have been, under the circumstances, only the *expression of an opinion as to the law* of the contract, and not a declaration or admission of a fact, such as would estop him from subsequently taking a different position as to the true interpretation of the written instrument." (Italics ours.)

Other authorities to the same effect are as follows:

> 21 C. J. 1147.
> 22 C. J. 296, 333, 335, 343, 423, 425.
> *Race* v. *Kurk*, 163 App. Div. 924, 147 N. Y. Supp. 818.
> *Rasseau* v. *Brookhart*, (Mich.) 139 N. W. 2.
> *Hazy* v. *Gage*, 2 Tex. 501.
> *Rawlins* v. *Neal*, 122 N. C. 173, 29 S. E. 93.

3. At pages 38-41 of his brief the Superintendent quotes language from the opinion of the Kansas Supreme Court in *Aetna Insurance Company* v. *Travis*, filed October 8, 1927 (not reported), wherein the Kansas Court holds that investment earnings of every kind, both on capital and surplus as well as on unearned premiums, must be taken into account in ascertaining profit or loss for rate-making purposes.

The Kansas court argues: "No reason suggests itself why the business of insurance should not be regarded as a whole." Having held that the business of the insurance companies must be regarded as a whole, disregarding the clear separation between the underwriting and investment activities of the companies, the Kansas

court proceeds to hold that income from all sources must be taken into account in ascertaining profit or loss for rate making purposes.

It might with equal reason be argued in railroad rate cases that the business of *transportation* must be regarded as a whole, and that income from interstate business should be taken into account in fixing intrastate rates. And in public utility cases it might with equal reason be argued that the entire business of the utility should be treated as a whole, and that the income from its electric light business should be taken into account in fixing its rates for street railway transportation.

The conclusive answer to the reasoning of the Kansas court on this point is that it is directly opposed to the rule which this court has uniformly applied (*Smyth* v. *Ames*, 169 U. S. 466, 540-541, and kindred cases). We have fully covered this point at pages 90-94 of our original brief, to which we respectfully refer the court.

It should be noted, moreover, that the Missouri Supreme Court has decided in favor of the petitioners upon the proposition that the underwriting activity and the investment activity are separate and distinct, and has refused to take into account $1,914,940 interest on capital and surplus, in arriving at the amount of profit or loss for rate making purposes (R. 3011-3012).

4. The Kansas court in the Travis case cites a number of early decisions which it says recognize the distinction between the insurance business and the banking business (*New York Fire Ins. Co.* v. *Ely*, 5 Conn. 560; *The Aetna Nat. Bank* v. *Charter Oak Life Ins. Co.*, 50 Conn. 167, 183; *Blair* v. *Perpetual Insurance Company*, 10 Mo. 559; *Ohio L. I. & T. Co.* v. *Merchants', etc.*,

Co., 11 Humphrey 1 (Tenn.); *Life Association of America* v. *Levy*, 33 La. Ann. 1203; *Huter* v. *Union Trust Co.*, 51 N. E. 1071 (Ind.); *Myers* v. *Mutual Life Ins. Co.*, 153 Ind. 204; *Robotham* v. *Prudential Insurance Co.*, 64 N. J. Eq. 673; *National Bank of Washington* v. *Insurance Co.*, 41 Oh. St. 1.) Those decisions have no bearing whatever upon any phase of the case at bar. They each deal with the question whether under the particular language of the corporate charter of an insurance company, it had the power to engage in certain lines of business. For example, in *New York Fire Ins. Co.* v. *Ely*, *supra*, the Connecticut court holds the insurance company had no power under its charter to engage in the business of loaning money on the discount of notes. And in *Life Association of America* v. *Levy*, *supra*, the Louisiana court held that under the language of its charter the particular insurance company there involved did have the power to invest its surplus profits in mortgage loans. And in *Huter* v. *Union Trust Co.*, *supra*, the Indiana court held that the particular insurance company there in question had no power under its charter to transact the business of a building and loan association. The other cases cited are similar to these. They simply deal with the question of *ultra vires*, which, of course, has nothing whatever to do with any question involved in the pending cause.

So far from the State of Missouri claiming that petitioners' investment activity is *ultra vires*, the claim is that it is an inseparable part of the underwriting activity, and that all income therefrom must be taken into account in fixing underwriting rates.

A conclusive reason why interest on unearned premiums is not properly to be taken into account is the

fact that gains by way of interest on invested moneys are not profits from the *operation of the business of insurance*. The first question to be determined in a rate case is whether the actual *operating* outgo is greater than the *operating* income. That is the case here, and that nullifies the rate reduction order.

III.

The deduction from petitioners' expenses of the sum of $2,496,715 commissions paid to their St. Louis agents, is unreasonable and confiscatory.

In his attempt to answer this point the Superintendent in his brief (at pages 47-48) speaks of the payment of commissions to agents in St. Louis as "gratuities"—seeking to create the impression that these commissions were mere gifts by the companies to their agents. The Superintendent has advanced no argument not covered in our original brief at pages 95 to 100.

Petitioners certainly did not voluntarily give away $2,496,715 of their money during this five-year period. The reason they paid it is because they were compelled to pay it by competitive conditions over which the individual companies have had no control.

IV.

The rejection of $628,123 war tax on premiums as an item of expense is unreasonable and confiscatory.

1. The Superintendent wholly fails to justify the disallowance of the Federal war tax on premiums. The tax was incurred and paid during the five-year test period. The payment thereof was as much a part of the

petitioners' experience of the test period as any other item of expense incurred. It will not do to say that because the war tax statute was repealed in 1921, the war tax paid during the years 1917 to 1921 should be thrown out of the calculation. The purpose of the calculation was to ascertain the five-year experience. This war tax was a part of that experience. It is unreasonable to exclude it.

2. At page 48-b of his brief the Superintendent says: "The Missouri Supreme Court did not in fact disallow this charge of $628,123, but simply stated it would not be charged against the companies in the future and should not be considered in the future fixing of rates." There can be no doubt as to the holding of the Missouri Supreme Court upon this point. The tabulation of the court's findings at record 3034-3035 clearly shows that in determining whether the 10 per cent reduction in rates is reasonable, the court deducted from the expenses of the test period the sum of $628,123 war tax on Missouri premiums. And in paragraph VIII of the opinion the court expressly holds that that item "should not be charged" (R. 3034). It will therefore not do to say that "the Missouri Supreme Court did not in fact disallow this charge of $628,123."

3. At page 48-a of his brief the Superintendent comments on the fact that petitioners are not here complaining of the disallowance of $542,933 Federal *income* tax. The petitioners believe that the disallowance of this item was unreasonable, unwarrantable and in direct conflict with the decisions of this court (*Galveston Electric Co.* v. *Galveston*, 258 U. S. 388, 399; *Georgia Ry. & Power Co.* v. *Railroad Commission*, 262 U. S. 625, 633). The reason why petitioners in this court

have not assigned error in the disallowance of this item is that the amount involved in the item is not sufficiently large, of itself, to change the result. Upon the figures adopted by the opinion below the rate reduction order is sustained by a margin of $607,040. The amount of the Federal income tax item is less than that sum, and is therefore not sufficient to affect the result. That is the reason why petitioners have not assigned error in the disallowance of the Federal income tax.

Of course, the Federal *income* tax and the Federal *war tax on premiums* are entirely separate, the one having nothing whatever to do with the other. The only apparent reason why the Superintendent has referred to the Federal income tax item at all is (quoting from page 48-a of his brief) "simply as an illustration as to how these insurance companies attempted to pad their expense accounts against the State of Missouri." This court having expressly held in the Galveston case and in the Georgia Railway case, above cited, that the Federal income tax is a proper item of expense to be charged in a rate making tabulation, the Superintendent's statement that the petitioners' inclusion of this item in their expense figure constitutes "padding," is nothing short of amazing.

The sum of $542,933 was actually incurred and paid by petitioners as Missouri's proportion of the Federal income tax for the five-year test period (Plaintiffs' Exhibit 1360 at R. 1930). The court's rejection of this item is based upon the finding that petitioners' figures showed "a net loss, so that no income tax was paid for Missouri"; yet the court in the concluding portion of its opinion holds that there was so great a profit in the

State of Missouri that the decrease in rates was justified. Both of these holdings cannot possibly be correct.

However, in following the Superintendent into a discussion of the Federal income tax item, we have wandered afield. The point at issue is as to the disallowance of the Federal war tax on premiums.

V.

The opinion below in fixing 8 per cent of premiums received, or $6,680,169, as a reasonable profit upon the business of the test period, without making allowance for the unearned premium reserve, is confiscatory; the fact being that petitioners were compelled, during the test period, to set aside unearned premium reserves in the average amount of $12,717,006, 60 per cent of which was drawn from premiums received.

Under section V of his brief the Superintendent advances a number of arguments which are foreign to the caption of his argument and which relate to the proper method of calculating underwriting profit. We have answered these arguments under section I of this brief, *supra*, and will not again touch upon them.

There is no other argument advanced by the Superintendent under section V of his brief which we have not fully covered at pages 102-104 of our original brief, to which we respectfully refer the court.

The argument of the Superintendent at page 57 of his brief, respecting the base upon which profit calculations should be made, relates to a subject matter which he also discusses under section XI of his brief. To avoid duplication we insert our answer to the argument under section XI of this brief.

VI.

The Rating Act (Sec. 6283, R. S. Mo. 1919) as now construed and applied by the Supreme Court of Missouri in the instant case is unconstitutional, for all of the reasons assigned herein.

The Superintendent in his brief under this point (page 58) says that the petitioners "stipulated and agreed in writing that the question of the constitutionality of such act should not be raised."

1. To avoid misunderstanding as to the state of the record upon this question we invite the court's attention to the language of such stipulation, which was filed in a former suit, before the making of the present rate order complained of (R. 1634-5, 27). The language of the stipulation relied upon by the Superintendent is as follows (R. 1642):

> "That in such matter the question of the constitutionality of Sections 6283 and 6284, Revised Statutes of Missouri, 1919, shall not be raised nor shall the legality of the hearing above provided for be questioned."

Such stipulation was made in a suit for an injunction to restrain a previous rate reduction order, and in such bill for injunction the constitutionality of such sections of the statute as written were challenged. After the filing of this stipulation, the former rate order was revoked, the suit for injunction dismissed and a hearing was had before the Superintendent, and a new rate order made which is the one here under review (R. 1634-5, 1640).

The original petition in the present suit alleges that the order of the Superintendent is confiscatory, and that it

> "takes into account $2,801,660 of alleged interest earnings on the capital and surplus of said companies prorated to Missouri, and $2,418,596 of alleged interest earnings on unearned premium reserves on Missouri business * * * and that the defendant's said order in so taking into account said alleged interest earnings and each class of said interest earnings in arriving at the amount of plaintiff's earnings in the state of Missouri, and in ordering a reduction of rates based thereon, deprives the plaintiffs and each of them of their property and property rights without due process of law and denies to the plaintiffs and each of them the equal protection of the laws and is confiscatory, unreasonable, unconstitutional and void, and in violation of Section 1 of the Fourteenth Amendment to the Constitution of the United States providing that no state shall deprive any person of property without due process of law." (R. 33.)

It is further alleged in the petition (R. 33):

> "Plaintiffs further state that the defendant, by his said order of October 9, 1922, bases his findings and determination of plaintiffs' alleged profit during said five year period upon the amount of premiums alleged to have been received or collected, the amount of losses and expenses alleged to have been paid out by plaintiffs during said five year period, instead of upon the amount of premiums earned and losses and expenses incurred by the plaintiff companies during said period; that by so doing the defendant, by his said order, deprives the plaintiffs and each of them of their property and property rights without due process of law and denies to them the equal protection of the laws and thereby violates the aforesaid pro-

visions of Section 1 of the Fourteenth Amendment to the Constitution of the United States."

It will be seen by a mere inspection of the stipulation that it provided that the contemplated rate order should not be enjoined on the ground of the unconstitutionality of the rating act. The petitioners have not by such allegations in their petition made any attack upon the statute, as such, but have made their attack upon the rate order, which is the confiscatory act complained of. The power which the Superintendent exercised in making his rate order was derived from the statute in question. But his power to act under the statute is not attacked. It is his *exercise* of power of which we complain. As this court has said in numerous cases where the circumstances are similar, it is the construction and application of the statutory power, resulting in confiscation, which are the object of attack; and this raises a federal question as clearly as if the statute itself were attacked. (*Myles Salt Co. v. Iberia Drainage District*, 239 U. S. 478, 484, and other cases cited at pages 110-111 of our original brief.)

2. The stipulation cannot be given the meaning which the Superintendent seeks to ascribe to it. To do so would be equivalent to stating that by stipulation made before a rate hearing, and under duress of a pre-existing and void rate order, the Superintendent could exact an agreement that no complaint would be made of any invasion of the rights of insurance companies by the Superintendent by his later rate order, no matter how gravely violative of their constitutional rights. If he should choose to make a rate order upon a purely fantastic, baseless and arbitrary method, having not even a semblance of reason, the insurance companies would be debarred of complaint, *even though they could not in advance have anticipated such*

action. The cases in this court are clear to the effect that such agreements, if made, are not enforceable.

> *Insurance Co.* v. *Morse*, 20 Wallace, 445.
> *Barron* v. *Burnside*, 121 U. S. 186.
> *Terral* v. *Burke Construction Co.*, 257 U. S. 529, 533.

3. While petitioners deny that they have violated either the letter or the spirit of the stipulation, yet we call the attention of the court to the fact that the Superintendent is in no position to invoke an estoppel against petitioners based on the stipulation. This because the Superintendent has failed to plead estoppel.

It will be noted that while the original petition attacked the order on the constitutional grounds above set forth, the Superintendent in his answer failed to plead as a defense that petitioners were estopped by their stipulation from asserting these constitutional points (R. 40-46). It is of course elementary that estoppel is an affirmative defense and must be pleaded. In *Laughlin* v. *Wells*, 314 Mo., l. c. 481, the Missouri Supreme Court says:

> "Estoppel is an affirmative defense, and when not pleaded (as here) the party desiring (if such was the desire in this case) to set it up, is concluded by a failure to plead it. *Avery* v. *Kansas City Southern R. R. Co.*, 113 Mo. 561."

See also *Bartlett* v. *McCallister*, (Mo.) 289 S. W., l. c. 820.

In any view of the matter the petitioners are clearly not precluded from asserting their constitutional rights herein.

VII.

If any single point of attack made by petitioners upon the rate reduction order is sustained, the order must fall.

In our original brief (at pages 108-109) we make the point that upon the figures adopted by the opinion below the rate reduction order is sustained by the very narrow margin of $607,040, and that if any one of petitioners' points is sustained, the order must necessarily fall, because each point involves more than that sum.

At page 62 of his brief the Superintendent denies that the rate reduction order is sustained by the margin of only $607,040.

The record as to this point is as follows: The court finds that $7,287,209 is the amount of profit which the companies would derive on the business of the five year test period, after applying the 10 per cent reduction. This appears in the last tabulation in the opinion (R. 3036).

The court likewise finds that the companies were entitled to a profit of $6,680,169 for the test period (see lines 7 to 10 on page 3035 of the record). The difference between $7,287,209 and $6,680,169 is $607,040.

Therefore, petitioners assert that upon the figures adopted by the opinion below the order is sustained by the margin of $607,040. The profit which the opinion says petitioners would earn with the reduction applied is only $607,040 in excess of the amount which the opinion finds would have been a reasonable profit.

At pages 64-69 of his brief the Superintendent quotes a part of the majority opinion purporting to summarize the profits of the petitioners upon their nation-wide business. This case, of course, involves only the experience of petitioners in Missouri, not their experience in the nation as a whole. Therefore, all of the discussion by

the court as to the nation-wide experience of the companies is irrelevant and beside the question. Moreover, the undisputed evidence is that upon the nation-wide business of all the petitioners during the five year test period the cash dividends paid were only *6.49* per cent of capital and surplus, and the cash dividends plus accretions to surplus were only *10 per cent* of capital and surplus (R. 1361-4, 1369). Considering the extremely hazardous nature of the business, this return upon the investment is certainly not "enormous."

Even if it were true that petitioners were deriving an excessive profit upon their nation-wide business, this would afford no basis for confiscatory rates in Missouri.

Smyth v. *Ames*, 169 U. S., l. c. 540, 541.
Minnesota Rate Cases, 230 U. S., l. c. 440.
Northern Pacific Ry. Co. v. *North Dakota*, 236 U. S., l. c. 585, 599.
Brooks-Scanlon Lumber Co. v. *Railroad Commission*, 251 U. S. 396.
Interstate Commerce Commission v. *Union Pacific R. R. Co.*, 222 U. S., l. c. 547.
Norfolk & Western Ry. Co. v. *Conley*, 235 U. S. 605.
Board of Public Utilities Commissioners v. *New York Telephone Co.*, 46 Sup. Ct. Rep. 363.

VIII.

While this court will accept the construction adopted by the Missouri Supreme Court in arriving at the meaning of the rating statute, nevertheless, if the statute as construed and applied or the rate reduction order as upheld by that court, deprive petitioners of property without due process of law, this court will reverse the judgment.

At page 71 of his brief, the Superintendent quotes from the opinion of Mr. Justice Sutherland in the case of *Supreme Lodge, Knights of Pythias* v. *Meyer*, 265 U. S., l. c. 32, to the effect that it is axiomatic that this court must accept the State Court's construction of state legislation. And at page 72 of his brief the Superintendent quotes from the opinion of Mr. Justice Van Devanter in *Des Moines National Bank* v. *Fairweather*, 263 U. S., l. c. 105, to the same effect.

We, of course, do not dispute that principle. We say that it does not apply, because when a law as construed and applied by the State Court violates the Constitution of the United States, this court will review and relieve against the judgment. We say that, adopting the construction of the statute by the Missouri Supreme Court, the petitioners' constitutional rights are denied, and that it is within the province of this court to grant petitioners relief.

The gist of the argument of the Superintendent under this point, as expressed at pages 72 and 73 of his brief, is that the earned and incurred basis of calculation is arbitrary and fundamentally unsound and productive of a false result. Naturally, if such position were well founded we would have no cause for complaint on such

phase of the case. But whether it be well founded is for this court to decide.

At page 73, the Superintendent attacks the method of computation of earned premiums and incurred losses and expenses. This discussion is entirely foreign to the subject matter comprised in the caption to his point. We have discussed this under portion I of this brief, where it properly belongs.

IX.

The decision below does not rest upon independent non-federal grounds. The federal rights asserted were of such character that no judgment adverse to the petitioners could be rendered without denying them; and they were necessarily denied by the result of the opinion and judgment below.

Every argument advanced by the Superintendent under point IX of his brief (pages 77-81) has been anticipated and fully answered at pages 112-114 of our original brief, to which we respectfully refer the court.

It should be noted that in every case quoted in the Superintendent's brief on this point (pages 79-81) it is stated in substance that it is sufficient to give this court jurisdiction if the "judgment as rendered could not have been given without deciding the Federal question." This is a recognition of the proposition for which we contend, namely, that the case is one which necessarily involved decision of Federal questions, and that by the very nature of the result reached the Federal rights asserted were necessarily denied.

At page 81 of his brief the Superintendent says that "no Federal question was passed on but that the decision was based on the general law of the land." We have, under a previous point in this brief, called attention to the allegations of the petition, expressly asserting that the rate order deprived petitioners of constitutional rights, in specified respects, against which relief was prayed. The opinion and judgment of the Supreme Court of Missouri refused the relief so prayed; and by its action, in upholding the arbitrary and confiscatory acts complained of, necessarily denied the constitutional rights asserted.

There is a clear inconsistency in the Superintendent's brief. At page 6 he says, "The court *did not pass upon any Federal question* because it was not necessary for a proper determination of the case." On the same page he also says, "Every question raised in this court *was expressly passed upon* by the Missouri Supreme Court." Certainly the Federal questions were raised. The Superintendent says at one place that every question raised was "expressly passed upon," and at another place on the same page he says that no Federal question was passed upon. It is impossible to harmonize such glaringly inconsistent statements.

X.

The questions which petitioners present herein are not questions of fact, but are questions of law, the decision of which this court has jurisdiction to review.

All of the arguments of the Superintendent under section X of his brief (pages 81-85) have been fully covered at pages 115-119 of our original brief.

However, in the apparent effort to confuse the issue upon this point the Superintendent says at page 83 of his brief: "The state questioned every one of their (the petitioners') figures and held that they had attempted to mislead the state." This statement of the Superintendent must not be construed to mean that there is any controversy over the figures upon which this case was tried, for these figures were *specifically accepted as correct by the state* during the trial (R. 2072), and are found by the opinion below to be *undisputed* (R. 3008-9, 3011); but the statement must be read in connection with what immediately follows, wherein the Superintendent says: "They were compelled by law to file sworn reports with Missouri each year showing their income and outgo, but when this case came on for trial they presented an entirely new set of figures much more to their advantage, so that it was purely a question of fact as to which set of figures was correct."

This contention, in the light of the record, is utterly preposterous. The reports to which the Superintendent refers were the so-called "Reports of Underwriting Experience by Classes." The blanks upon which these reports were made were prepared by someone in the Insurance Department who evidently had a very hazy idea of exactly what information was desired. The blanks were ambiguous, misleading and incomplete, covering only a portion of the classes of business written by the petitioners; they varied, in that the information and data called for was different from year to year; and as a result of their admittedly incomplete and confusing form, the amounts of premiums, losses and expenses reported in such blanks were not the same as the amounts of premiums, losses and expenses upon which this case

was tried. But obviously they could not be the same, because the underwriting blanks called for information as to only a *part* of the classes of insurance written, and not *all* classes, whereas the figures in evidence upon which the case was tried included *all* classes. Therefore necessarily the two sets of totals could not possibly correspond (R. 1855-1908, 196-7, 380-6, 387-393, 443-6, 535-6, 603-7, 668-9, 675, 2083-5, 2273).

It is an untrue statement of the issue presented to say that it was "purely a question of fact as to which set of figures was correct." *Neither side contended or under the record could contend that the figures reported in the "Reports of Underwriting Experience by Classes" could be a proper predicate for the determination of this case.*

XI.

As to the proper base against which underwriting profit should be figured.

In his brief the Superintendent advances two different theories as to the base against which underwriting profit should be figured, to-wit, (a) the value of petitioners' agency plants, and (b) a ratable part of their capital and surplus apportioned to Missouri.

The Missouri Supreme Court adopted neither of these theories, and held (R. 3011):

> "A reasonable profit, it seems to be agreed, is five per cent on the *underwriting business done*, with three per cent addition for conflagration hazard."

And the court further held (R. 3012):

> "The law relating to public service corporations contains features unlike anything in the rating act for insurance companies. The public service corporations are regulated in a way to insure them a reasonable return on their capital invested after defraying expenses. Often they are monopolies having no substantial competition. Insurance companies always have active competition among each other. The rating act was intended to remove the temptation to pool in violation of the anti-trust laws and to prevent ruinous competition. The statute contemplates that the rates shall be fixed with a view to the aggregate earnings and profits for the insurance business in the state. Each company may make as much money as it can. Some may make enormous profits, some may do a losing business, but the average profit, that is, the aggregate profit on the aggregate business, must be reasonable. *That seems to be sufficient reason for taking the business done and not the capital invested, as a basis for measuring a reasonable profit.*" (Italics ours.)

A discussion of this question, in the light of the evidence, is purely academic. This for the reason that if all proper items of operating outgo are subtracted from proper items of operating income, there was no operating profit remaining, but instead there was a loss, on the business of the test period. Therefore the discussion of what would constitute the proper base upon which to figure a reasonable return (had there been a profit), is the discussion of a purely moot question.

But inasmuch as the Superintendent has advanced his theories upon the matter, we think it proper to answer them, and to submit our theory in reply.

1. At page 85 of his brief, the Superintendent advances the remarkable suggestion that petitioners' profit should be calculated upon the value of their agency plants in Missouri, on the theory that this is the extent of their property devoted to the use of the business.

The utter absurdity of this suggestion can best be illustrated by demonstrating what it would mean if adopted. The agency plants of the petitioners were of a value at the end of the test period of $4,265,302, as shown by the evidence summarized at page 121 of our original brief. This is the figure upon which the Superintendent would calculate a reasonable return to petitioners. We may ascertain what he regards as a reasonable return from page 63 of his brief, where he says that "6 per cent is the ordinary and usual profit allowed a utility, and in some instances 7 per cent." Applying the higher figure, 7 per cent, to the value of the agency plants would mean that all the companies in Missouri combined would only be entitled (under the Superintendent's theory) to earn $298,571.14 per year. There are 157 companies in the state (R. 2-5). So the average profit per year per company would be the munificent sum of $1,919.70.

Under this remarkable theory of the Superintendent, an insurance company entering the State of Missouri, building up an agency plant and business in the state, establishing hundreds of agents in the various cities, towns and villages of the state, assuming millions of dollars of potential liability, incurring the risk of conflagration losses that might happen at any time, must be content to receive a maximum profit of $1,919.70 per year!

This theory of the Superintendent is so fantastic as to need no other answer than this showing of its result, if applied. If insurance companies were limited to a profit not exceeding 6 per cent or 7 per cent upon the value of their agency plants, it would mean that each company, on the average, would earn annually from its entire operations in the great State of Missouri about enough profit to equal the salary of one clerk or stenographer.

2. At pages 57-58 of his brief the Superintendent suggests that profit should be figured upon petitioners' capital and surplus apportioned to Missouri in proportion to the business done in Missouri as compared with the business done in the United States. In effect, the Superintendent would apply to insurance companies a rule analogous to that applied to public utilities.

But there is a fundamental difference between the business of insurance and that of public utilities. In the case of a public utility the property of the company is dedicated to the public use; the state may exercise control in the detail of its management, even against the will of the owner; the utility operates by virtue of a franchise and dedicates its property to the public use upon acceptance of the franchise, thereby creating a contract under which it can be compelled to operate its property, and it can abandon its business only by the express consent of the state; and it must do business with all members of the public indiscriminately. On the other hand the business of insurance is a private business; while it is affected with a public interest (*German Alliance Ins. Co.* v. *Lewis*, 233 U. S. 389), yet it nevertheless remains a private business, in the sense that its property is not dedicated to the use of the public, but

remains the private property of the company. The insurance company is not compelled to do business with members of the public generally; it may restrict its business to such persons and such risks as it may see fit.

There is this further difference: In the case of public utilities the capital of the utility is directly employed in the business, and is invested in the instrumentalities with which the public service is rendered, to-wit, rails, ties, depots, engines, poles, wires, gas mains, etc. In the business of insurance capital is not employed in the business in this sense. The business of insurance consists in the rendition of service by way of payment of indemnity for losses sustained, without employment of tangible property. In a true sense it may be said that the capital of an insurance company is not employed in the business at all, and is by law barred from being used in the business. It is by law required to be kept as a reserve or guarantee fund; and the moment the capital is intrenched upon to carry on the business it constitutes an impairment of capital which bars the company from doing business (Secs. 6222, 6348, R. S. Mo. 1919).

There are substantial reasons why the basis upon which the profit to a public utility should be calculated (the value of the property used and useful in the business) is not applicable in the case of an insurance company. For example, in the case of an electric company, it is not sought to fix a charge for electricity by a level of rates applicable to all electric companies through the state; each company is dealt with separately as a distinct unit; and the theory of the law is that each shall be entitled to a reasonable return upon its particular investment. What is there considered is a fair return upon the property used and useful in the business, and a rate is fixed

which will enable the particular utility to make a reasonable profit. The theory applied to insurance companies is entirely different from that. No effort is made to see that each insurance company has a reasonable return upon its capital or upon its business, because to enable one company to make a reasonable profit might require a larger charge than to enable another company to make a similar profit. To do so would permit different charges of premium by different companies for the same insurance service. The law seeks to obviate this situation and puts all companies into one group or mass, and without seeking to give a return to each, seeks to determine what would be a reasonable return considering them en masse. The result of adjusting rates upon the basis of an average reasonable return to all companies necessarily means that the best managed or more fortunate companies will derive more than such reasonable return, and those less fortunate or less skillfully managed will do business at a loss. It may well be that those which make the largest return upon their business through skillful management or good fortune, may have only nominal capital; and that with the same rates of premium those with the largest capital investment may, through misfortune, make no money at all, or lose large sums. The capital of the companies has no direct bearing upon the business, and is not a matter proper for consideration.

If it were sought to establish a basis of a return upon capital, the complaint would justly lie with a company that if it did double the amount of business of another company with an identical capital, it should not be restricted to the same profit, because, by the larger volume of the business conducted its possibilities of loss would be multiplied many times, and it would be receiv-

ing no indemnity for taking this additional responsibility. Two companies, each having a capital of $200,000, and one writing business on which the premium income was $100,000 and another company, with like capital, writing business upon which the premium income was $300,000, would undertake risks say of one hundred times, more or less, the amount of premiums derived. Thus, a company with $200,000 of capital might be assuming $10,000,000 of risks while the other company would be assuming three times that amount, or $30,000,000 of risks. It would therefore, if it were confined to the same rate of return upon what happened to be its capital, be assuming $20,000,000 of risks, upon which it would be denied any compensation whatever.

It seems incontrovertible that a company doing a large volume of business should be proportionately paid for its service. It would seem unjust that a company with half the capital of another should receive only half the return, although doing double the business.

The theory of allocating to a state a portion of capital and surplus is basically unsound. Witness *Wilfrid Kurth* said on this question (R. 844):

> "The whole of the capital and surplus are pledged to the carrying out of the contracts we have with Missouri policyholders."

The same witness was interrogated respecting the propriety of taking an allocated part of capital or capital and surplus in the proportion that Missouri premiums bear to United States premiums, and treating them as a base against which to compete profit, and in answer to

a question as to the propriety of such a course said (R. 845):

> "Why, it is utterly fallacious in my opinion. In the first place, in the event of the destruction of St. Louis or Kansas City it would probably be necessary to take a considerable portion of the combined capital or at least of the surplus of the companies. If we undertook to segregate our capital and surplus in that method there would be a very small percentage of our security behind our policies in any given state. Whereas the capital and surplus must be kept liquid to meet excessive liabilities wherever they may arise, if they do arise; like at San Francisco, or the Baltimore conflagration. On the other hand, if the company did a railroad or a telegraph business in the state and had certain fixed assets within the state, it would be reasonable to appraise such assets and consider that the capital within the state. No such thing exists with an insurance company."

At page 1520 of the record the same witness testified further on the same point:

> "The impossibility of justly determining profits on the basis of a return on capital and surplus arise out of the fact:
>
> Foreign companies do not have capital and surplus in this country in any relation to the business here done but remit their excess earnings to foreign countries.
>
> American companies in some cases do business throughout the entire world and if capital and surplus can be said to form any kind of basis for earnings, there is a marked element of error in that their business is not confined to the United States but extends over the whole world.
>
> Many companies do business only in a limited number of states and in some cases in only a very few states.

The effect of undertaking to compute profits on capital or capital and surplus is necessarily to make Missouri rates profit or suffer by the experience in other states. If all of the earnings of the companies in the United States be considered and it be determined for example that they are entitled to 10 per cent upon capital and surplus from their entire operations, this furnishes no guide unless it be sought in some way to relate the resultant figure to the Missouri business.

If this be done by proportioning, say on the basis of premium writings, it would produce the following consequences (this is on the theory of prorating on basis of premium writing):

If the premiums for the United States for all companies be assumed to be $800,000,000 during a given year and the Missouri premiums be assumed at $20,000,000, the proportion would be one-fortieth. Let it be assumed that the capital and surplus of all companies is $1,000,000,000. A 10 per cent return on this would be $100,000,000. Missouri paying one-fortieth, the profit to be derived would be $2,500,000. During the succeeding year, let it be assumed that the capital remains the same, namely $1,000,000,000, the business in Missouri is identical, namely $20,000,000, but the business in the remainder of the United States increases only 10 per cent to $880,000,000. The proportion of the Missouri business, $20,000,000, to the country's premiums, instead of 2.5 per cent, is now 2.2 per cent so that Missouri would have its charge reduced to the extent of $480,000, although its business remained absolutely identical in every particular and the capital and surplus of the companies remain absolutely identical. If on the contrary Missouri's business during a third year still remained identically the same as during the preceding two years, but the premiums in the remainder of the United States fell off 25 per cent, due to cessation of insurance upon exports from the state of New York, the result upon

Missouri would be that with an identical business written upon identical property and with the capital and surplus of the companies identical, the business of the country being reduced to $600,000,000 and Missouri remaining at $20,000,000, the latter would have to produce of $100,000,000 profits 3.3 per cent or $3,300,000.

Thus during three years with capital and surplus of all companies identical, the amount of business in Missouri identical, the character and number of risks exactly the same, and no change whatever except the amount of business done in the remainder of the United States fluctuating, Missouri would pay one year $2,500,000, a second year $2,020,000 and the third year $3,300,000. It may be seen that despite an effort to base returns on capital and surplus, the effort fails and the matter comes back to an inquiry as to the volume of business transacted, to which the premium rate must of necessity relate and be governed. Insurance is a service and must be compensated as a service, dependent upon the character, skill, fidelity and nature of the service. The rate of return must be dependent upon volume and is as strictly determined by the volume transacted irrespective of the amount and extent of investment as truly as is the compensation of a commission merchant or a professional man.

It will be seen that any basis tentatively considered leads back to productivity and like every private enterprise (railroads, telegraph lines and public utilities of that type, operating pursuant to franchise, with their capital invested in tangibles, are an exception) is measured respecting its return by the percentage of earnings upon volume of business done."

We respectfully submit that in no event would it be proper to figure a proper return upon the base of capital and surplus apportioned to Missouri.

3. However, as above pointed out, since upon the business of the test period, calculated upon the proper method, the items of outgo exceeded the items of income, resulting in loss instead of profit, it is a moot question whether, in measuring a reasonable profit, the base used should be the "volume of the business" (earned premiums), or the "capital used and useful in the business." In *Norfolk & Western Ry. Co.* v. *West Virginia*, 236 U. S. 623, this court dealt with a similar situation in this language:

> "The result of his figures show that operating expenses and taxes consume 97.4203 per cent of the total income on this class on this division. It is apparent, from either point of view which this record permits, that the statutory rate at most affords a very narrow margin over cost. It is manifestly not a case where substantial compensation is permitted and where we are asked to enter the domain of legislative discretion; *nor one in which it is necessary to determine the value of property employed in intrastate traffic*. It is clear that the company is forced to carry passengers even at or below cost with mere nominal reward. We find no basis whatever upon which the rate can be supported, and the state exceeded its power in imposing this rate." (Italics ours.)

4. It is worthy of note that in the Missouri Supreme Court the Superintendent advanced neither of the two theories now advanced in this court, but in that court agreed with petitioners that "a reasonable profit is 5 per cent on the underwriting business done, with 3 per cent additional for the conflagration hazard" (R. 3011). The theories now advanced by the Superintendent constitute a complete change of front on his part since the submission of the case to the Missouri Supreme Court.

5. Counsel for the Superintendent have made an assertion at page 48b of their brief which they have reasserted in various other parts of the brief. This assertion is that:

> "The Missouri Supreme Court was undertaking to allow these companies an 8 per cent return because that is what they said they were entitled to. * * * As a matter of fact, this court has repeatedly held that a 6 per cent return is sufficient and we do not believe any court has ever set aside a reduction where a 6 per cent return was provided. So that we have a margin of nearly $3,000,000 above an 8 per cent return and of course much more above a 6 per cent or 7 per cent return."

It would seem hardly necessary to point out the fallacy of undertaking thus to compare a return of 8 per cent computed against *premium volume* (whether against the earned or the received premiums) with a return of 6 or 7 per cent upon property used and useful in a business. The 8 per cent considered by the Missouri Supreme Court is applied by that court against a base entirely variant from the base against which this court has applied 6 and 7 per cent returns.

For all the reasons presented in the original brief and in this reply brief, we respectfully ask that the judgment of the Missouri Supreme Court be reversed.

Respectfully submitted,

CHARLES E. HUGHES,
ROBERT J. FOLONIE,
WILLIAM S. HOGSETT,
JOHN S. LEAHY,
ASHLEY COCKRILL,
Counsel for Petitioners.